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The Railroad Week in Review
1/24/2003

BNSF operating metrics continue to improve. Loco and car miles per day, train size, and productive crew starts are at or near record levels. Carload and non-unit train ag cars racked up a record 71% on time at-dock arrival plus or minus 24 hours. Stripping out the early cars, only 13% of shipments missed their delivery commitments by more than 24 hours. Chief Operating Officer Carl Ice told me after the conference that shortlines can help by minimizing dwell at interchange even as BNSF strives to minimize its own connection times.

Freight revenues were flat for the fourth quarter and off 2% for the full year. Carload revenues were off 3% for the Q and 6% for the year mainly due to grain and automotive. The only real bright spot was intermodal, up 5% in both the Q and the year. The operating ratio remained stubbornly north of 80 once again, closing the year at 81.3, up a full point yoy. The quarterly OR was somewhat better, 80.8, though still lagging 4Q01's adjusted 79.4.

During the earnings conference it became painfully clear (and this bore out through the rest of the week's meetings) that mandated adjustments to GAAP reporting are clouding the issue. Fourth quarter 2002 earnings came in at 54 cents. In 4Q01 BNSF reported 46 cents a share. Now they have to take out the 11 cents for costs related to 2001's workforce reduction program making the adjusted prior year 57 cents a share. Thus a nice 17% gain yoy turns into a 5% decrease.

Since none of this affects the way the core business is run, I'm going to ignore it and use GAAP. Consequently I'm giving BNSF credit for raising eps to $2.00 from $1.87 yoy, up 7% rather than adding back 19 cents in adjustments making last year's eps $2.08 and creating a paper loss of 4%. Out on the railroad the 2% 4Q decline in ops expenses (including a 7% reduction in equipment rents) helped, while the 2% expense decline for the year merely reflected the 2% decline in freight revenues.

Canadian National was next up. The big news, broken by Chief Commercial Officer Jim Foote, is that CN is going to revamp its intermodal operating model so it looks more like the carload model. Now there's a switch. We keep hearing about how the complex carload business must be simplified to look more like the intermodal model and here we have CN, with arguably the most efficient railroad on the continent, going the opposite way. What gives?

For the first time ever anywhere we actually heard it said out loud that intermodal margins are less than carload margins, that not all containers are created equal, and that the price-lane-service equation applies equally to the intermodal business. The focus is on selling balance to speed up asset turns and maximize contribution. Getting it down to one lift (switch) per customer, adding penalties for equipment delay (demurrage), and matching the service to the need could be worth points off the OR.

Turning to the financials, the challenge is once again sorting out how the railroad really performs from the GAAP and adjusted numbers. As reported, full-year eps dipped to $C3.97 from $C5.23, off 24%. But excluding the items that affect yoy comparability adjusted net income was up 8%. Using pro forma numbers assuming the WC acquisition occurred 1/1/2001 (it was really 10/9) carload revenue excluding coal and intermodal was off 3% for the quarter and flat for the year with the big hit in grain.

All-in revenues (again using the WC pro forma formula) were flat for the quarter and year at $C1.5 bn and $C6.1 bn respectively. The full year OR comes in at a respectable 69.4 if you back out the $C401 mm in adjustments from the “official” $C4.6 bn expense line. CEO Hunter Harrison told me after the meeting, “With the complexities of reporting and the WC transaction it’s getting harder and harder to get clear yoy comps. First quarter 2003 yoy comps will be cleaner, however we feel yoy cash flow is the superior measure in this environment. CN’s Free Cash Flow margin (see chart) was 11% and amounted to $C674 mm.

Union Pacific’s Chief Commercial Officer Jack Koraleski says that they use “a portfolio of measures” to gauge how well they’re doing. Trip Plan Compliance (TPC) shows how well the operating department gets cars over the road. The Customer Satisfaction Index (CSI, WIR 8/23/2002) tells UP how well performance meets or exceeds shipper expectations, and Revenue per Unit (RPU) flags real economic value to the customer. The afternoon’s presentation played on all three themes.

For the quarter commodity revenue, carloads, and RPU were up in auto, chems, and industrial products by a point or two more than the full year increases. CEO Ike Evans confirmed for us that this is a leading indicator of an improving economy and this is further borne out by the AAR’s Weekly Traffic Reports for the last few weeks of 2002 and the opening weeks of 2003.

There is an interesting development in UP’s auto business. Already UP touches about a third of all the autos produced in the US. It was the only transport company to win an award in GM’s Top Eight Vendors category. And the business is growing at a CAGR of 5%. On the parts side, UP has become a formidable truck competitor, and, like the CN, seeks to model that business segment along the lines of its best merchandise carload model. That is to say, using TPC+CSI+RPU to hone results.

Commodity revenues were up 3% for the quarter and year. There is a $200 mm quarterly spread and a $500 mm yearly spread between that number and operating revenue. CFO Jim Young tells me that represents ancillary charges from demurrage to log services. Operating income was up 1% for the quarter and a whopping 12% for the year with ORs of 80.1 and 79.8 respectively. Corporate earnings on a diluted share basis were up 37% to $1.41 from $1.06, though 31 cents of the gain came from land sales and tax adjustments. Even without these adjustments full year earnings rose 14% to $4.30 from $3.77 a year ago.

Short interest on the NYSE as of Jan 15 fell for the third month in a row. Among the major rails UP and NS both saw percentage increases in the teens while CSX rose 27%. Granted, UP said rising fuel costs and a one-time charge for employee severance could cut first quarter earnings by as much as 15 to 20 cents. But a first quarter does not a year make. We have yet to hear from NS and CSX, but the yoy comps (WIR 1/17/2003) are encouraging.

Roy Blanchard writes and consults on railroad commercial, financial and operating best practices for shortlines and shippers. Disclosure: Blanchard may from time to time hold long, short, debt or derivative positions in the companies mentioned here. A list of such holdings is available on request.

Sample Operating and Financial Metrics

Railroad	BNSF	CNI	UP
Ticker	BNI	CNI	UNP
All dollar amts but per-share in MMs		($CDN)	
Year ending	12/31/02	12/31/02	12/31/02
Price at yr end ($US)	$ 26.01	$ 41.56	$ 60.08
Dill shares (mm)	380.80	202.00	276.80
Market cap ($US)	$9,904.6	$8,395.1	$16,630.1
Revenues	$8,979.0	$6,110.0	$12,491.0
Operating Expenses	$7,323.0	$4,240.0	$10,167.0
Operating Income	$1,656.0	$1,870.0	$2,324.0
Net income (corporate)	$760.0	$1,152.0	$1,341.0
Earnings per share	$ 2.00	$ 5.70	$ 4.84
Divs per share	$ 0.48	$ 0.74	$ 0.92
Div payout	24.1%	13.0%	19.0%
Cash Flow			
Ops cash flow	$ 2,106.00	$ 1,612.00	$ 2,250.00
Capex	$ (1,459.00)	$ (938.00)	$ (1,887.00)
FCF before divs	$ 647.00	$ 674.00	$ 363.00
FCF Margin	7.21%	11.03%	2.91%
Railway Statistica Data			
Op Ratio	81.6%	69.4%	79.8%
Equip Rents as % RR revs	7.8%	1.3%	11.1%
Revs/mile	$ 271	$ 343	$ 289
Revs per unit (RPU)	$ 1,097	$ 1,467	$ 1,222
Revs/emp	$ 228,957	$ 263,476	$ 235,930
Revs/MRTM (cents)	18.32	3.82	2.15
CL/route mile	247.2	233.7	236.2
CL/emp	208.7	179.6	193.1
RTMs/gal	417	426	394
MRTM/emp	12,501	6,894	10,967
Load to empty ratio	54.7%	51.7%	52.2%
RTMs/CL	59,887	38,395	56,806
Tons/car	80.00	80.00	80.00
Average length of haul	748.59	479.94	710.08